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**FISCAL IMPACT STATEMENT**

**LS 7560**

**BILL NUMBER: SB 541**

**NOTE PREPARED: Jan 13, 2009**

**BILL AMENDED:**

**SUBJECT:** Various Tax Matters.

**FIRST AUTHOR:** Sen. Hershman

**FIRST SPONSOR:**

**BILL STATUS:** As Introduced

**FUNDS AFFECTED:** X GENERAL  
X DEDICATED  
FEDERAL

**IMPACT:** State & Local

**Summary of Legislation:** *Sales Tax:* The bill makes changes to bring Indiana in conformance with the Streamlined Sales and Use Tax Agreement as amended through September 5, 2008. It updates the definition of "gross retail income" to coincide with the definition of "sales price". It requires the use tax to be paid at the time of registering a watercraft that is a United States Coast Guard documented vessel. It provides relief for retail merchants if there is a change in the sales and use tax rate. It makes permanent the sourcing rule for floral deliveries providing that a sale is sourced to the location of the florist where the order originated when the sale involves one florist taking an order and transferring the order to another florist for delivery to the final recipient. It also provides that the sale of Internet access service or certain ancillary service telecommunication services are sourced to the customer's place of primary use.

*Inheritance Tax:* The bill provides that an Inheritance Tax lien terminates on the earlier of: (1) the date the Inheritance Tax is paid; (2) when certain affidavits are filed specifying that no tax is due; or (3) ten years (rather than five years, under current law) after the date of the decedent's death. The bill also changes the Inheritance Tax interest accrual date.

*Corporate Tax:* The bill incorporates the real estate investment trust income add back into the Financial Institutions Tax. It provides that an Australian real estate investment trust or a listed property trust will not be included in the add back to Corporate Adjusted Gross Income as a captive REIT.

*Income Tax:* The bill adds a definition of "pass through entity". It provides that income from a pass through entity shall be characterized in a manner consistent with the income's characterization for federal income tax purposes and attributed to Indiana as if the entity that received the income had directly engaged in the income producing activity. The bill, for purposes of the tax credit for contributions to the college choice 529

education savings plan: (1) defines "contribution" to exclude rollovers from other 529 savings plans; and (2) excludes value added to the account through earnings of bonus points. It specifies that only the account owner or the account owner's spouse is eligible to claim the credit. It provides that the credit may not exceed the taxpayer's net contributions to the college choice 529 education savings plan during the taxable year. It provides that the ability to opt out of electronic filing when using a paid tax preparer is available only to a taxpayer who claims the additional exemption for the elderly or who has opted out of participating in federal Social Security programs because of religious beliefs. It also provides that for winnings that exceed \$1,200 on gambling games at racetracks, the operator is required to withhold adjusted gross income tax from the winnings.

*Local Option Income Tax:* The bill amends the county adjusted gross income tax, county option income tax, and county economic development income tax statutes to provide that the Budget Agency (rather than the Department) certifies the revenue distribution to counties.

*Fuel Tax:* The bill provides that September 1 is the deadline for International Fuel Tax Agreement applications to be filed in order to receive the permit by January 1. It requires the Department to provide relief under the gasoline tax statutes where a shipment of gasoline is legitimately diverted from the represented destination state after the shipping paper has been issued by the terminal operator or where the terminal operator failed to cause proper information to be printed on the shipping paper. It repeals the requirement that a person must obtain an import verification number in certain circumstances to import special fuel into Indiana.

*Commercial Vehicle Excise Tax:* The bill specifies that road tractors are included in the definition of "commercial vehicle" for purposes of the commercial vehicle excise tax. It provides that a taxing unit's calendar year commercial motor vehicle excise tax distribution is based on the amount of tax collected in the preceding state fiscal year (rather than 105% of the prior year's base revenue). It also provides that a county's base revenue for purposes of the commercial motor vehicle excise tax is equal to its distribution percentage multiplied by the amount of tax revenue collected in the preceding state fiscal year.

*Vehicle Repair Permit:* The bill allows a repair and maintenance permit to be used by unregistered off-road vehicles to move from and to a quarry for the purpose of repair.

*Airport Operator Reporting:* The bill requires an airport operator to submit reports to the Department listing aircraft stationed at the airport. It provides that if the airport operator submits an incomplete report, the airport operator is subject to a civil penalty of \$100 per aircraft not properly included in the report.

*Other Department of State Revenue Procedures:* The bill requires the Department of State Revenue (Department) to post on the Department's web site the name of every registered retail merchant that has not renewed its retail merchant certificate or whose certificate has been revoked. The bill specifies that the Department has the sole authority to furnish forms used in the reporting of information in an electronic format. It requires all new withholding tax registrants to file returns and remit the withholding taxes electronically through the Department's online tax filing program. It requires new retail merchants to file returns and remit sales tax electronically. The bill allows the Department to use statistical sampling in audits. It provides that if the taxpayer and the Department agree on a sampling method to be used, the sampling method is binding on both parties. It specifies that if the Department erroneously issues a refund check to a taxpayer, the Department has two years from the time of issuing the erroneous refund to issue a proposed assessment. The bill requires (rather than allows) a taxpayer to round to the nearest dollar amount on income tax returns. The bill provides that partnerships and trusts are subject to the 20% penalty for failure to

withhold and remit taxes required to be withheld for nonresident partners or nonresident beneficiaries. It provides that if a person has had more than one payment to the Department returned for insufficient funds, the Department may require that all future payments for all listed taxes be remitted with guaranteed funds. The bill allows the Department to require a taxpayer that is on a payment plan for sales or withholding tax liabilities to make the payment using an automatic withdrawal from the person's bank account.

**Effective Date:** Upon passage; January 1, 2008 (retroactive); January 1, 2009 (retroactive); July 1, 2009; January 1, 2010; July 1, 2010.

**Explanation of State Expenditures:** *Electronic Filing Provisions:* The bill imposes electronic filing requirements on persons registering as retail merchants and entities registering to withhold Individual Adjusted Gross Income (AGI) Tax after December 31, 2009. The bill requires these persons or entities to report and remit Sales and Use Tax or file the withholding tax report and remit withholding taxes electronically through INtax - the DOR's online tax filing program. The bill does not apply to retail merchants registered before January 1, 2010, but adding an additional place of business after December 31, 2009. The electronic filing requirements for retail merchants and entities withholding AGI Tax are expected to result in future administrative savings to the DOR. These savings are indeterminable.

*Tax Preparer Electronic Filing Exemptions:* Current law requires a professional tax preparer who files more than 100 returns in a calendar year to file these returns in electronic format unless the taxpayer provides a written request that the return not be filed electronically. The bill provides for another exemption from the electronic filing requirement. Under the bill, a professional preparer would not have to file electronically if a taxpayer or the taxpayer's spouse: (1) is 65 years old or older; or (2) has elected for religious reasons not to participate in the Social Security Program. This exemption could potentially result in an indeterminable increase in administrative cost to the DOR in processing tax returns.

*Other Provisions:*

(1) Other provisions of the bill expected to result in minimal reductions in administrative cost are as follows:

- Requiring instead of permitting rounding to the nearest dollar of amounts on an income tax return.
- Requiring persons on a payment plan with the DOR to make periodic payments via electronic funds transfer.
- Requiring payments to the DOR with guaranteed funds when payment by a person cannot be collected and the person is assessed a 100% bad check penalty.

(2) Other provisions of the bill expected to result in minimal increases in administrative costs are as follows:

- Requiring DOR to compile and publish on its Internet website a list of retail merchants whose certificates have not been renewed or whose registration with the DOR has been revoked.

**Explanation of State Revenues:** *Treatment of Intermediary Pass Through Income:* The bill clarifies the treatment of income paid from an Indiana pass through entity to a pass through entity domiciled in another state. Based on the Tax Court's decision in *Riverboat Development, Inc. v. Indiana Department of State Revenue* (Cause No. 49T10-0506-TA-52) February 22, 2008, income received by a non-Indiana pass through entity from its interest in an Indiana pass through entity is, under current statute, not taxable income for purposes of the Individual Adjusted Gross Income (AGI) Tax. As a result, the non-Indiana pass through entity is not required to withhold AGI Tax on distributions to its shareholders. Under the bill, the income

received by the intermediary pass through entity would be treated as business income from sources in Indiana, and the pass through entity would be required to withhold AGI Tax on distributions it makes to its shareholders. The tax court case voided a \$2.3 M assessment the DOR made against Riverboat Development, Inc. However, the assessment had never been paid. This provision could potentially result in a significant future increase in withholdings and AGI Tax revenue from taxpayers conducting these activities.

*Captive REIT Addback:* The bill establishes the same captive real estate investment trusts (REIT) addback for purposes of the Financial Institutions Tax (FIT) that exists under current statute for purposes of the Corporate Adjusted Gross Income Tax. Under current statute, a captive REIT is a REIT that is owned or controlled by (or captive of) a single corporation. Current statute requires a corporate taxpayer to add back amounts deducted from federal taxable income that represent dividends paid to the corporation by a captive REIT. The bill would require the same for a financial institution under the FIT. The amount of revenue that could potentially be captured due to the FIT add back is indeterminable and dependent on the number of financial institutions currently utilizing captive REITs to reduce taxable income.

A REIT is a corporation, trust or association that acts as an investment agent specializing in real estate and real estate mortgages. Under the Internal Revenue Code a REIT, unlike an ordinary corporation, is entitled to claim a deduction for dividends paid to shareholders against their ordinary income and net capital gains. A REIT must meet certain requirements as to ownership and organization, source of income, investment of assets, and distribution of income to shareholders. The financial institution captive REIT model could involve an Indiana financial institution that establishes a REIT to hold its mortgages or mortgage backed securities. Instead of the mortgage interest income accruing to the financial institution that pays FIT, the interest income accrues to the REIT. The REIT can avoid Corporate AGI tax by claiming the dividends paid deduction and would pass the income through to the shareholders of the REIT, which could be an affiliate of the financial institution in another state not subject to Indiana tax.

The bill also specifically excludes “Australian real estate investment trusts (REITs)” and “listed property trusts” from the definition of a captive REIT under the existing corporate tax provisions. These entities are currently interpreted to be excluded from the add back, so the amendment will have no fiscal impact.

*529 Contribution Credit:* The bill imposes three additional limits on claiming the tax credit for contributions to College Choice 529 Education Savings Plan accounts.

- (1) The bill provides that only the owner of a 529 account is eligible to claim the tax credit.
- (2) The bill specifies that contributions resulting from bonus points or other forms of consideration earned by the account owner (i.e. a bonus points program for credit card purchases) do not qualify for the tax credit.
- (3) The bill specifies that money transferred (under a rollover) from another 529 qualified tuition program to the account do not qualify for the tax credit.
- (4) The bill limits the tax credit to the net annual contributions made to a 529 savings plan account. The net contribution is the amount contributed by the taxpayer during the taxable year minus the sum of qualified withdrawals and non-qualified withdrawals made by the taxpayer during the taxable year.

The extent to which the provisions described in (1) and (2) would lower the revenue loss or mitigate future revenue loss from the tax credit is unknown. The provision described in (3) may mitigate some future revenue loss, but it is assumed that most of the rollover activity resulting in tax credits has probably already

been completed. The provision described in (4) above could potentially result in a significant reduction in the revenue loss from the tax credit. The precise impact of this provision, however, is indeterminable.

*Streamlined Sales Tax:* The bill changes the definition of “gross retail income” for purposes of the Sales Tax and makes three other changes for purposes of conformity with the Streamlined Sales Tax agreement. The bill sources internet access and telecommunications ancillary services to the customer’s place of primary use, and sources floral wire delivery orders to that florist who takes the original order. The bill also requires at least 30 days between enactment and effective date of a Sales Tax rate change for retail merchants to be liable for failure to collect tax at the new rate. These changes are not expected to result in a fiscal impact.

*Withholding on Slot Machine Winnings:* The bill includes the slot machine facilities at the horse racetracks under current statute requiring riverboat casinos to withhold and remit income tax on gambling winnings of: (1) \$1,200 or more from a slot machine play or (2) \$1,500 or more from a keno game. It is estimated that the current withholding requirement applicable to the riverboat casinos results in an additional \$21.8 M in AGI Tax revenue from out-of-state gamblers who otherwise would not pay the tax on winnings. This provision could potentially generate additional withholdings to the extent that out-of-state gamblers are patronizing the slot machine facilities. However, these facilities may have a much smaller out-of-state market than the riverboat casinos. The additional revenue yield is indeterminable at this time.

*Inheritance Tax:* The bill makes the following changes relating to the Inheritance Tax both changes are expected to result in minimal revenue increases.

(1) The bill changes the time frame for the termination of the inheritance tax lien on property transferred by a decedent. The lien terminates by current statute either once the earlier of when the tax is paid or 5 years after the decedent’s date of death. The bill extends this time frame to 10 years after the decedent’s date of death.

(2) The bill changes the deadline for refunding tax erroneously or illegally collected before interest accrues at 6% per annum. Currently, the refund must be provided within 90 days after the refund claim is filed with the DOR. The bill would change the deadline to 90 days after the later of the filing of the refund claim or receipt of the tax return by the DOR. Reportedly, the DOR tends not to even receive the tax returns from the counties within 90 days of the refund filing.

*Erroneous Refunds:* The bill allows the DOR to issue an assessment to recover refunds that are erroneously provided. The bill provides that an assessment must be issued: (1) within 2 years after making the refund; or within 5 years after making the refund if the refund was induced by fraud or misrepresentation. This provision could potentially lead to an indeterminable savings due to recovery of erroneous refunds.

### **Explanation of Local Expenditures:**

**Explanation of Local Revenues:** *CVET:* Under current law, each taxing unit’s Commercial Vehicle Excise Tax (CVET) distribution is equal to 105% of the amount that the unit received in the prior year, going back to the base year. The CVET tax rate is calculated by dividing the amount needed to make the unit distributions by the commercial vehicle registration fees paid in the previous year. The rate is applied to current registrations to generate the current year CVET liability for each vehicle.

Under this bill, beginning in 2009, the base revenue amount for each taxing unit would equal the previous fiscal year’s CVET revenue apportioned in the same percentage as the revenue was distributed in 2001 (and

each year thereafter).

There are two effects from this change. First, taxing units are no longer guaranteed to receive an annual 5% increase in their CVET distributions. This bill would, in effect, freeze the rate. The amount of revenue received each year would be directly tied to the percentage change in registration total fees paid on commercial vehicles. If total fees go up, then the CVET revenue would increase. If total fees drop, then the CVET revenue drops. However, because of the issue cited below, the revenue received in 2009 would be slightly reduced because it would be based on 2008 actual collections. Total CVET collections were \$62.5 M in FY 2008.

The other effect is to fix a problem with the rate calculation under current law. Registration fees for farm vehicles are one-half as much as they are for other vehicles. In order to compensate for this difference, the amount of registration fees paid on farm vehicles was doubled in the CVET rate formula. However, farm vehicles now pay one half of the regular CVET tax amount. The result is a shortage in available funds to make the guaranteed distributions to local units.

**State Agencies Affected:** Department of State Revenue.

**Local Agencies Affected:**

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